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CHARTING A COURSE FOR THE FUTURE: HOW DIFFERENT FIRM CATEGORIES NAVIGATED A PROFITABLE 1985

Following a record year and a record first quarter start for the securities industry as a whole, it would seem hard to find any albatrosses circling this ocean of black ink. But it all depends on whose ship you're on. From the decks of the U.S.S. Large Investment Bank, there appeared nothing but blue sky on the horizon. The same could be seen from the U.S.S. Commission Introducing, but an albatross or two were discernable from the crow's nest. For the New York City and Regional navies, the deck hands were still busy scattering these pests which perched on their bows from the voyage of the early Eighties. And for the National Full Line armada, the ships were still listing from their passage through the choppy straights of 1984.

HIGHLIGHTS

1. The securities industry's 1985 record pre-tax profits was gratis of the 10 large investment banks and a small group of "other" securities houses which achieved record profits last year. The National Full Line, Regionals, Discounters, Commission Introducing and New York City Based firms all had better profits in 1983.
2. The 20 NFL and LIB firms, which make up 5% of all NYSE firms doing a public business, accounted for three-quarters of this group's revenues and two-thirds of its profits.
3. While concentration marches on at the top of the securities industry pyramid, the small "other" group at the bottom is also chipping away at the middle group's market share.
4. Even though the industry showed record profits in 1985, profit margins were still being squeezed. Two firm categories were actually pinched: NFLs, albeit the perennial low show, have trailed even the U.S. manufacturing industries' low margins for the last two years while NYSE Discounters since 1984 have trailed the industry in profit margins and last year managed to outpace only the NFLs.

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CONCENTRATION'S CONTINUED MARCH

But Not All The Non-Majors Are Losing

The securities industry giants last year again left a dwindling slice of the industry's revenue and profit party cake for the rest of the group. It must be remembered, though, that revenues aren't everything. A lot of the non-giants had much better ROEs than their bigger brethren. Still, for the non-25-largest capitalized firms, which account for about 94% of the group, their share of industry revenues has consistently and radically fallen over the last seven years. In 1979 this majority swath of the industry accounted for about one-third of all revenues (32.7%). This steadily declined through the Eighties by 10 percentage points to where last year they only garnered 22.8% of the industry's revenues.

This isn't to say that their aggregate revenues are declining. In fact, they have more than doubled over the same time span to \$8.8 billion. What it does show is how the bigger capitalized firms have been able to foster a much faster revenue growth rate.

Table 1

Securities Industry Concentration, 1979-1985

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
<u>Total Revenues</u>							
Top 10	48.7%	53.1%	55.6%	57.3%	54.4%	58.8%	57.5%
Top 11-25	18.6	19.4	18.7	18.7	19.6	17.1	19.7
Rest of Industry	32.7	27.5	25.7	24.0	26.0	24.1	22.8
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
<u>Total Capital</u>							
Top 10	45.8%	50.8%	50.0%	54.8%	52.8%	57.2%	63.2%
Top 11-25	18.8	18.0	19.7	18.3	18.8	15.6	14.8
Rest of Industry	35.4	31.2	30.3	26.9	28.4	27.2	22.0
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Firm rankings are by capital and change from one year to another.

Source: Securities Industry Database

Table 2
STATEMENT OF INCOME
TOTAL SECURITIES INDUSTRY
(In \$ millions)

REVENUE	1980	1981	1982	1983	1984	1985
Commissions	5682.1	5339.6	6011.9	8350.2	7094.6	8235.4
Listed Equities, On an Exchange	4237.5	3954.7	4484.1	6131.5	5232.6	6069.8
Listed Equities, OTC	44.6	72.8	61.0	112.4	75.0	92.3
Options	714.8	608.4	737.4	797.5	822.3	881.4
All Other	685.2	703.6	728.9	1308.6	964.7	1205.0
Gains/Losses from Trading Accounts	3137.8	4237.5	5951.5	6839.0	7563.8	9944.3
Mkt Making-OTC Equities	664.4	607.3	655.7	1381.3	862.9	1229.8
OTC Mkt Making-Listed Equities	60.3	38.3	37.7	51.7	45.7	52.5
Trading-Debt Securities	1894.2	3081.3	4454.6	4418.1	5524.9	7206.5
Mkt Making-Options	1.9	-1.0	11.1	63.6	31.1	159.1
All Other Trading	577.3	549.7	828.4	982.7	1147.7	1348.7
Gains/Losses from Investment Accounts	560.1	573.7	606.8	738.1	713.8	1089.2
Realized Gains/Losses	426.2	570.1	380.1	495.7	697.7	837.9
Unrealized Gains/Losses	104.0	-23.7	159.9	166.2	-10.4	187.3
Profits/Losses from Underwriting	1327.8	1568.1	2316.1	3541.4	2706.1	4250.3
From Equities	403.3	424.1	328.2	754.5	248.3	748.4
Margin Interest	2088.7	2890.1	2010.5	2129.5	2867.8	2577.7
Revenue from Sale of						
Investment Company Shares	104.7	122.0	287.5	952.1	750.9	1642.8
Fees-Supervision, Advisory, Administrative	175.4	274.8	356.1	569.5	693.8	947.4
Revenue from Research Services	14.3	15.8	8.3	18.7	11.1	17.8
Commodities Revenue	625.4	580.5	663.0	826.1	739.3	983.2
Other Revenue-Securities-Related	1727.6	2965.4	3942.3	4385.0	6282.8	7176.4
Other Revenue	586.1	1229.1	1055.9	1216.8	1792.1	1757.7
Total Revenue	16029.7	19796.1	23210.0	29566.4	31216.0	38624.2
EXPENSES						
RR Compensation	3049.8	3334.2	4103.6	5750.2	5248.5	6003.1
Clerical & Admin. Employee Expenses	2548.1	3086.3	3702.8	4889.8	5147.5	6218.4
Partners & Officers - Employment Expenses	567.8	648.2	753.9	982.1	934.1	1119.9
Other Employee Comp. *	169.7	190.5	258.0	448.2	396.1	331.3
Floor Expenses	753.6	725.4	863.8	1142.9	1162.6	1310.3
Brokerage Paid to Brokers	263.2	265.3	316.7	390.1	399.1	441.9
Commissions & Clearance	283.0	246.6	275.7	390.4	395.3	459.5
Clearance Paid to Non-brokers	162.2	156.1	207.9	246.6	257.9	285.3
Commissions Paid To Others *	45.2	57.4	63.5	115.8	110.3	123.0
Communications	837.5	1103.3	1270.3	1538.4	1766.4	1921.8
Occupancy & Equipment	514.1	678.4	853.3	1138.4	1503.7	1830.7
Promotional Costs	347.2	456.9	530.2	735.1	769.2	841.5
Interest Expense	3444.8	5684.7	5480.7	6057.5	9505.4	10127.6
Losses-Errors and Bad Debts	204.5	153.6	193.3	233.0	212.0	266.3
Data Processing Costs	156.1	216.7	273.1	342.8	419.8	477.8
Non-recurring Charges	30.9	16.7	6.9	98.5	26.2	98.9
Regulatory Fees and Expenses	65.9	79.2	100.9	133.9	144.9	244.8
Other Expenses	1077.2	1280.7	1784.3	2251.3	2372.3	2797.4
Total Expenses	13767.4	17651.8	20175.4	25742.9	29608.2	34481.2
Net Income	2262.3	2144.3	3034.6	3823.5	1607.6	4140.0
Net Income-After Tax	1221.6	1157.9	1638.7	2064.7	868.2	2235.6

* From FOCUS Short Form, IIA

Out of the top 25 firms, it is the upper echelon group which keeps cutting the bigger revenue slice. The Top 10 capitalized firms have seen their share of industry revenues grow from just under half in 1979 to 58% last year. The Top 11-25 group has held steady at about 19% annually over the same years.

The inroads made by these Top 25 firms and the drop-off experienced by the "rest" are anything but evenly distributed.

The Top 25 firms are predominantly made up of National Full Line firms and Large Investment Banks.¹ Here we see that the two groups as a whole, which make up a mere 5% of the number of NYSE firms in this study, have increased their share of the group's revenues from a whopping 69% in 1980 to a staggering 75% last year. However, the LIBs made impressive inroads accounting for 31% of revenues last year vs 23% in 1980 while the NFLs' share of industry revenues fell from 46% back in 1980 to 43% last year.

Table 3

Firm Category	Number Of Firms	% of All Firms	Firm Category's % Of Revenues					
			1980	1981	1982	1983	1984	1985
National Full Line	10	2 1/2	46	42	43	44	42	43
Large Investment Banks	10	2 1/2	23	29	30	28	32	31
	20	5	69	71	73	71	74	75
Regionals	104	26	14	14	12	12	10	10
New York City Based	52	13	8	8	6	6	5	5
	176	45	91	92	91	90	90	90
Commission Introducing	124	31	3	3	3	4	3	2
	300	76	95	94	94	93	93	93
All Other	94	24	5	6	6	7	7	7
	394	100	100	100	100	100	100	100

Source: Securities Industry Database
(from FOCUS Reports of 394 NYSE firms doing a public business)

Notes: Totals variations due to rounding; no firm is included in more than one category.

¹/The NFLs consist of six Top 10 firms and four Top 11-25 firms. The LIBs contain the remaining four top 10, four more 11-25 firms and two sub-25 firms.

Conversely, at the bottom of the pyramid the "other" securities firms, which include clearing firms, traders and market makers as well as "non-categorized" firms, have also been slicing a bigger piece of the revenue pie. They have improved their share of all revenues, going from 5% of all revenues in 1980 to 7% last year. Naturally if both the top and bottom of the pyramid are improving their share of revenue, the middle is losing. The main groups which are slicing smaller shares, besides the NFLs, are the Regionals, down from 14% of revenues in 1980 to 10% last year and the New York City Based firms, down to 5% in 1985 from 8% in 1980.

These groups show a similar pattern of in-roads and lost market share when it comes to the bottom line. The NFLs and LIBs together still enjoyed 65% of the industry's pre-tax profits in 1985, about their norm through the Eighties. But again, here the LIBs are gaining while the NFLs decline. Large Investment Banks have improved their share of profits dramatically, from 29% in 1980 to 43% last year. NFLs, conversely, fell from 35% of pre-tax income in 1980 to 23% last year (1984 was an aberration...in that off year, NFLs lost money while LIBs raked in 72% of the year's disappointing profits). And again at the bottom of the pyramid, the "other" securities firms have improved their 1980 9% share of pre-tax income to 15% last year.

Thus, as would be expected from their declining portion of revenues, the Regionals and the NYCs have also experienced declining share of industry profits. For the Regionals, it fell from 15% to 9% over the six-year period and from 9% to 6% for the NYCs.

Table 4

Firm Category	Number Of Firms	% of All Firms	Firm Category's % Of Pre-Tax Net Income					
			1980	1981	1982	1983	1984	1985
National Full Line	10	2 1/2	35	27	29	29	(7)	23
Large Investment Banks	10	2 1/2	29	41	40	36	72	43
	20	5	64	68	68	65	65	65
Regionals	104	26	15	14	10	12	5	9
New York City Based	52	13	9	9	7	8	9	6
	176	45	88	90	85	85	79	81
Commission Introducing	124	31	4	3	4	5	5	4
	300	76	91	93	89	91	85	85
All Other	94	24	9	7	11	9	15	15
	394	100	100	100	100	100	100	100

Source: Securities Industry Database
(from FOCUS Reports of 394 NYSE firms doing a public business)

Notes: Totals variations due to rounding; no firm is included in more than one category.

NATIONAL FULL LINE FIRMS

Having lost \$118 million as a group in 1984, the only major firm category^{2/} to post in the red during this down period, or for all of the Eighties for that matter, 1985 was a more than welcome return to profitability. The \$16.7 billion revenue showing last year was a record amount for the NFLs but comprised 43% of all industry revenues, a bit less than the 46% share this group enjoyed back in 1980.

On an itemized basis, the NFLs' line by line revenue performance closely mirrored that of the industry as a whole (as would be expected since this group makes up 43% of the industry's revenue totals). The NFLs' 1985 share of industry commissions was also 43%. But just four years earlier, NFLs accounted for over half of industry commissions. And just like the total industry as a group, the relative importance of commission dollars to the bottom line has been steadily declining. From 1980 to 1985, the contribution which commission revenues made to all revenues for the NFLs fell from 37% to 21%. For the industry the decline was almost identical, dropping from 35% in 1980 to 21% last year. And just like the industry as a whole, the NFLs' commissions last year fell short of the monies raised from this area in 1983. As reported in last month's TRENDS, the industry, and particularly the NFLs, find themselves in the position where they need more transactions to generate the same commission dollar.

In the area of trading gains, the increased importance to the bottom line is even more dramatic for the NFLs than the whole industry. While this area's share of total revenues increased from 20% to 26% for the industry from 1980 to 1985, it went from 16% to 27% for the NFLs. The same explosion in debt trading the industry latched onto as a revenue generator, the NFLs homed in also with a vengeance. This area accounted for 78% of all NFLs' trading gains in 1985.

Underwriting revenues likewise exploded to over \$2 billion for this group last year. That made up 13% of NFL revenues, way up from the 8% underwriting contributed back in 1980. But the industry's total underwriting revenues were also way up to a record \$4.3 billion and the NFLs' share of it was just under half, not as good as earlier years when the NFLs accounted for over half of all industry underwriting revenues.

^{2/}The 16 Non-Carrying NYSE Discounters, as a sub-category of all Discounters, was the only other group to post an annual loss in the Eighties, a 1984 pre-tax loss of \$1.8 million.

Table 5
STATEMENT OF INCOME
NATIONAL FULL LINE FIRMS
(In \$ millions)

REVENUE	1980	1981	1982	1983	1984	1985
Commissions	2717.0	2407.2	2696.7	3528.7	2935.5	3523.6
Listed Equities, On an Exchange	1940.0	1739.3	1952.4	2656.1	2162.7	2636.4
Listed Equities, OTC	24.7	25.9	25.7	42.1	29.6	23.0
Options	449.6	390.0	465.7	447.2	472.1	519.4
All Other	294.1	252.0	244.4	443.9	245.0	344.8
Gains/Losses from Trading Accounts	1244.9	1445.9	2280.0	2491.8	3037.5	4505.8
Net Making-OTC Equities	362.3	324.9	369.4	779.7	529.2	722.1
OTC Net Making-Listed Equities	60.1	34.7	34.0	50.9	43.0	51.4
Trading-Debt Securities	675.5	1069.7	1453.7	1991.0	2337.5	3460.2
Net Making-Options	14.3	2.1	5.6	0.2	5.2	5.9
All Other Trading	192.3	45.3	52.9	121.1	170.3	317.4
Gains/Losses from Investment Accounts	72.5	92.6	7.0	36.6	104.4	92.4
Realized Gains/Losses	65.0	113.5	5.2	32.5	115.9	47.5
Unrealized Gains/Losses	7.5	-20.4	2.4	-5.0	-5.2	3.9
Profits/Losses from Underwriting	634.3	720.6	1254.8	1592.9	1456.6	2074.7
From Equities	147.7	179.8	151.1	277.2	57.0	374.0
Margin Interest	1265.4	1698.1	1174.0	1200.5	1546.6	1357.1
Revenue from Sale of						
Investment Company Shares	61.4	74.3	204.1	777.3	549.6	1146.0
Fees-Supervision, Advisory, Administrative	56.0	91.3	133.4	249.6	245.1	397.2
Revenue from Research Services	0.0	5.2	0.0	2.1	-1.2	0.0
Commodities Revenue	574.9	521.5	587.7	703.3	649.1	624.4
Other Revenue-Securities-Related	593.4	999.2	1169.9	1524.5	1979.0	12515.7
Other Revenue	105.3	259.5	375.6	519.0	559.5	365.5
Total Revenue	7326.1	8325.6	9688.7	12923.1	13066.3	16712.3
EXPENSES						
HR Compensation	1456.3	1959.3	2452.0	3450.7	3245.5	4157.0
Clerical & Admin. Employee Expenses	1341.0	1022.0	1953.6	2627.1	2730.1	3338.1
Partners & Officers - Employment Expenses	49.5	109.4	134.1	177.1	190.5	204.2
Other Employee Costs, *	0.0	0.0	10.0	0.0	0.0	0.0
Floor Expenses	241.1	250.5	306.2	361.6	346.9	374.3
Brokerage Paid to Brokers	110.4	110.5	125.2	141.7	131.3	140.6
Commissions & Clearance	72.0	55.4	63.6	82.9	75.3	91.3
Clearance Paid to Non-Brokers	97.4	84.5	121.4	137.2	140.3	152.4
Commissions Paid To Others *	0.0	0.0	0.0	0.0	0.0	0.0
Communications	496.0	544.0	767.3	923.0	1045.5	1157.1
Occupancy & Equipment	290.2	365.2	472.6	630.1	660.8	1067.8
Promotional Costs	201.3	266.6	324.7	464.0	456.9	500.4
Interest Expense	1218.5	1732.2	1460.3	1757.3	2522.2	3137.1
Losses-Errors and Net Debits	159.7	123.3	133.9	152.9	144.5	180.2
Data Processing Costs	47.3	104.9	134.9	144.4	197.3	191.7
Non-recurring Charges	20.1	3.5	5.0	94.5	12.3	55.6
Regulatory Fees and Expenses	28.0	32.7	39.0	46.3	49.2	123.9
Other Expenses	461.2	555.7	821.4	976.9	1042.7	1225.4
Total Expenses	6530.1	7745.3	9017.6	11813.8	13184.3	15772.8
Net Income	796.0	577.3	471.1	1109.3	-118.0	939.5
Net Income-After Tax	429.3	311.7	470.4	599.0	-63.7	537.3

* From FOCUS Short Form, III

All in all, the NFLs pretty much match industry trends but are slightly trailing industry revenue growth, now accounting for 43% of the total vs 46% back in 1980.

On the flip side of the income statement, the NFLs employment costs still expend nearly half of all revenues coming in. Of that total, RR compensation still eats up a quarter of all dollars brought in and clerical and administrative employee expenses are still using up another one-fifth. The 10 NFLs are still accounting for 60% of all RR compensation paid by the 396 NYSE firms doing a public business.

Table 6

EMPLOYEES

<u>Firm Category</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
National Full Line	80,989	92,871	100,330	112,572	122,538	127,522
Large Investment Banks	15,774	17,841	19,923	23,948	25,124	26,957
Regionals	N/A	31,236	31,500	34,308	36,183	35,648
New York City Based	N/A	10,894	10,868	11,193	11,716	12,351
NYSE Discounters	N/A	611	1,214	1,618	2,080	2,683
Total Securities Industry*	139,825	160,628	170,966	191,970	207,477	214,621

* Includes other firms categories.

Total employment expenses of the NFLs last year accounted for 53% of industry employment expenses. That's not a bad ratio since the NFLs employ a higher 59% of the industry's people...127,522 NFL employees last year vs. 214,621 NYSE member firm employees. Interest ate up 19% of revenues last year, which was less than the 21% it took in the previous year but still higher than the 14% to 15% share interest took in a couple of previous years. The year-to-year percentage drop is partly explained by the corresponding drop in interest rates and the longer-term increase is explained by the explosion of liabilities on the balance sheet (See TRENDS, 4/9/86). The NFLs accounted for 31% of the industry's interest expense, exactly the share the NFLs' \$116 billion of 1985 year-end liabilities made up of the total industry's balance sheet. NFLs' communications costs have held steady as a percent of revenues in the 7% to 8% range over the years. Meanwhile, occupancy and equipment expenses' bite on revenues has nearly doubled since 1980, from 4% to 7% last year.

As usual, the NFLs' expenses are the highest in the industry relative to revenues and thus their profit margins are the thinnest. Back in 1980 the NFLs had a 10.9% pre-tax margin. This has steadily deteriorated to a mere 5.6% margin last year (discounting 1984 when NFLs posted in the red). In every year NFLs' margins underperformed all firm categories and the industry's margins. However, since 1984, the NFLs have also been underperforming the low margins of the U.S. manufacturing industry and those years weren't even good ones for this group!

The positive note, however, is that in the fourth quarter of last year, as happened for the entire industry, the NFLs' margins improved and the gap between this group and the industry in general narrowed.

Table 7

PRE-TAX PROFIT MARGINS
(In %)

<u>Firm Category</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6
Regionals	14.7	11.2	11.1	12.6	2.6	9.4
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3
Commission Introducing	16.9	10.9	15.9	18.8	9.5	19.8
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9
All Other	22.7	13.6	24.8	19.2	13.5	24.8
Total Securities Industry	14.1	10.8	13.1	12.9	5.2	10.7
U.S. Manufacturing Cos.	7.7	7.4	5.3	6.3	7.1	5.9

One of the buzzwords of the Eighties has been "financial supermarket". It was widely predicted, particularly in the financial press, that the future belonged to one-stop shopping for financial services. While these financial giants have added a lot to their aggregate bottom line by the addition of Wall Street goliaths in their own right, the low margins NFLs suffer by trying to be all things to all people suggest financial supermarkets may end up with narrower margins than other firms but probably not as bad as the razor-thin margins which have historically plagued their namesakes in the food industry.

LARGE INVESTMENT BANKS

There is one category of securities firms which are the envy of the industry. Not only are they the envy of the industry but seem to be pretty popular outside this group as well. Less than a year ago only one of these 10 investment banks could be directly owned by investors through the purchase of common stock. And this stock kept soaring to new highs. But over a few short months three more of these premiere securities firms gone public and another has given up its private partnership status to another financial parent as a sixth had done several years earlier. This leaves only four of this group still in partners' private hands.

Their popularity is not surprising. As seen earlier, these 10 firms, making up a mere 2 1/2% of the NYSE firms doing a public business, have increased their share of all the NYSE group's revenues to 31% last year, up from a still impressive 23% in 1980. Their share of pre-tax earnings last year was even more staggering...43%. And they weathered the storm better than other firms. In 1984's off-year, these 10 firms accounted for 72% of the 394 NYSE firms' (doing a public business) pre-tax profits.

Their profit margins, as seen earlier, consistently outperform the industry as a group, though they're not the highest of all categories (smaller groups, in terms of revenues, such as Commission Introducing, Traders and Market Makers and "others" have higher margins but obviously much less profits in aggregate). Likewise, their ROEs consistently outperform the industry, but again aren't the highest of all. This is partly due to their immense leverage and thus lower relative equity bases (this may be tempered somewhat in the present year due to some of these bank's initial public offerings and sell-outs to financial conglomerates). Their level of leverage last year was a staggering 42 times assets to equity. Not only was that 2 1/3 times the next largest leverage figure for a major group (the NFLs' 18X assets to equity) but it was up substantially from a 31X leverage ratio just two years earlier.

Table 8

LEVEL OF LEVERAGE (Assets to Equity)

<u>Firm Category</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
National Full Line	15X	14X	13X	15X	18X	18X
Large Investment Banks	32	31	34	31	36	42
Regionals	9	11	9	8	9	9
New York City Based	29	19	13	13	15	14
Commission Introducing	4	4	4	5	3	2
NYSE Discounters	4	6	8	6	7	9
Total Securities Industry	19	18	19	18	22	24

Table 9
STATEMENT OF INCOME
LARGE INVESTMENT BANKS
(In \$ millions)

REVENUE	1980	1981	1982	1983	1984	1985
Commissions	651.7	661.6	202.6	1215.4	1068.1	1127.1
Listed Equities, On an Exchange	543.4	564.4	702.3	1044.5	915.0	967.2
Listed Equities, OTC	3.0	20.3	6.1	14.5	2.1	4.0
Options	44.1	37.6	57.3	57.2	70.4	74.1
All Other	37.3	37.3	34.0	82.0	80.7	81.1
Gains/Losses from Trading Accounts	1273.0	2042.1	2675.1	2706.2	3397.4	3474.2
Mkt Making-OTC Equities	91.3	70.4	80.5	243.7	118.5	163.3
OTC Mkt Making-Listed Equities	0.0	0.0	0.0	0.0	1.9	7.0
Trading-Debt Securities	1003.6	1672.5	2094.6	2013.4	2701.6	3020.0
Mkt Making-Options	5.5	-10.7	-9.1	41.9	-2.7	102.3
All Other Trading	172.7	309.9	503.3	404.2	580.0	565.0
Gains/Losses from Investment Accounts	277.0	318.1	217.0	365.4	364.1	409.2
Realized Gains/Losses	217.5	334.6	195.7	241.5	342.5	471.9
Unrealized Gains/Losses	59.6	-20.5	21.3	83.7	21.6	-63.5
Profits/Losses from Underwriting	331.4	364.0	560.0	1050.0	733.9	1370.0
From Equities	120.2	119.8	99.3	230.1	97.5	223.2
Margin Interest	216.4	232.4	183.0	269.4	395.4	373.5
Revenue from Sale of						
Investment Company Shares	1.0	1.8	2.6	9.9	11.3	24.7
Fees-Supervision, Advisory, Administrative	15.2	51.3	57.3	84.6	111.4	171.6
Revenue from Research Services	0.5	0.4	0.0	0.4	0.4	0.3
Commodities Revenue	13.4	15.1	19.7	62.2	64.8	290.2
Other Revenue-Securities-Related	662.5	1327.5	2060.5	1980.4	3324.6	3483.4
Other Revenue	230.0	626.9	361.4	454.1	639.5	951.0
Total Revenue	3573.8	5545.9	6944.4	8209.2	10102.9	12697.5
EXPENSES						
DR Compensation	433.3	441.0	604.0	456.7	786.1	1123.3
Clerical & Admin. Employee Expenses	464.0	575.2	794.4	1047.5	1139.6	1301.7
Partners & Officers - Employment Expenses	122.4	143.2	193.4	269.2	300.8	401.4
Other Employee Comp. *	0.0	0.0	0.0	0.0	0.0	0.0
Floor Expenses	24.7	98.3	143.1	202.9	215.4	217.3
Brokerage Paid to Brokers	28.6	54.0	76.7	106.3	120.6	131.4
Commissions & Clearance	30.5	27.5	38.7	65.0	59.9	44.5
Clearance Paid to Non-Brokers	15.6	16.8	27.7	31.6	35.4	31.7
Commissions Paid to Others *	0.0	0.0	0.0	0.0	0.0	7.0
Communications	104.1	140.6	171.6	231.2	260.8	247.4
Occupancy & Equipment	76.4	100.5	133.7	205.5	258.7	317.0
Promotional Costs	55.4	66.4	79.3	109.5	134.7	179.4
Interest Expense	1509.6	2559.1	3157.0	3358.0	5319.2	5722.3
Losses-Errors and Bad Debts	11.0	13.5	21.0	28.9	20.9	24.0
Data Processing Costs	25.9	37.8	45.4	68.2	85.4	141.0
Non-recurring Charges	0.1	0.5	0.0	0.0	0.2	7.0
Regulatory Fees and Expenses	5.2	7.8	10.1	22.5	27.6	31.4
Other Expenses	216.3	264.9	345.0	415.1	393.5	615.4
Total Expenses	3024.0	4774.7	5739.0	6435.9	8947.5	10332.0
Net Income	649.8	771.2	1205.4	1373.3	1155.4	1765.5
Net Income-After Tax	350.5	470.4	650.9	741.6	623.9	953.4

* FROM FOCUS Short Form, IIA

The increased leverage came from a doubling on the LIBs' balance sheet of liabilities over the past two years from \$106 billion at 1983's close to \$209 billion this past December. Going back to 1980, we find a five-fold increase in total liabilities to date. The growth in ownership equity over the same time frames lagged the debt increases. For the two-year span, ownership equity had a one-and-one-half-fold increase and since 1980 it experienced a four-fold increase to \$5.2 billion on December 31, 1985. Again, the new infusions of capital from mergers and initial public offerings in 1986 may balance-out these increasing balance sheet rates.

As opposed to the NFLs' client base crossing the broad spectrum of the American public, the LIBs' targeted clientele and product lines creates a huge disparity in the level of employment and revenues per employee for these two groups.

As seen earlier, though the NFLs accounted for a greater 43% of industry revenues last year than the LIBs' 31%, the LIBs' targeted market approach allows them to function with far less, one-fifth, the number of employees than the NFLs employ. This allows the LIBs to reap in more than triple the amount of revenues per employee than the NFLs and two-and-one-half times the industry as a whole.

Table 10

<u>Firm Category</u>	<u>\$ REVENUE PER EMPLOYEE</u>					
	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
National Full Line	90,458	89,647	98,564	114,799	106,631	131,054
Large Investment Banks	232,905	316,464	348,562	342,793	402,115	448,771
Regionals	N/A	87,054	89,061	105,926	89,531	112,629
New York City-Based	N/A	136,390	131,905	156,669	145,487	167,684
NYSE Discounters	N/A	189,096	176,248	213,809	171,313	180,680
Total Securities Industry*	114,641	123,242	135,758	154,016	150,455	179,951

* Includes other firm categories.

This industry-best performance is even more pronounced when looking at profit per employee since the LIBs targeted strategy allows them to capture the biggest share of industry profits, 43% last year. In 1985, the LIBs' perennially industry-best performance in pre-tax profit per employee jumped 42% from the previous year to a huge \$65,497 profit per person. That's nine times the NFLs' level and more than triple the industry level.

Table 11

STATEMENT OF INCOME
REGIONAL FIRMS
(In \$ millions)

	1980	1981	1982	1983	1984	1985
REVENUE						

Commissions	1059.1	966.1	1039.0	1013.0	1175.5	1352.3
Listed Equities, On an Exchange	711.4	646.2	680.9	681.4	724.4	831.6
Listed Equities, OTC	10.7	16.1	16.4	27.9	11.5	15.7
Options	106.2	69.9	102.7	114.3	129.0	128.7
All Other	230.4	234.1	239.2	399.9	300.1	376.0
Gains/Losses from Trading Accounts	330.5	401.1	497.3	596.2	530.4	712.3
Net Making-OTC Equities	144.0	150.6	147.0	254.5	173.7	229.9
OTC Net Making-Listed Equities	0.1	-0.2	0.1	0.0	0.2	0.4
Trading-Debt Securities	134.0	199.5	285.5	260.7	290.3	399.1
Net Making-Options	0.4	-2.0	-3.3	4.0	0.6	1.2
All Other Trading	51.0	53.2	66.4	82.0	62.6	81.4
Gains/Losses from Investment Accounts	22.1	29.1	56.4	34.3	17.2	57.0
Realized Gains/Losses	12.6	23.0	56.4	25.3	23.1	36.0
Unrealized Gains/Losses	9.6	6.0	-0.0	8.9	-5.0	19.1
Profits/Losses from Underwriting	249.5	332.6	369.3	430.9	396.0	592.2
From Equities	42.2	108.2	62.5	195.0	70.6	106.9
From Interest	324.4	503.6	311.4	307.9	400.3	277.7
Revenue from Sale of						
Investment Company Shares	30.7	41.7	64.5	138.3	161.1	370.2
Fees-Supervision, Advisory, Administrative	24.9	29.8	36.4	46.2	43.7	56.0
Revenue from Research Services	3.0	1.4	3.8	10.7	6.3	11.0
Commissions Revenue	30.8	31.4	36.2	42.8	40.0	44.4
Other Revenue-Securities-Related	140.7	265.1	314.5	346.4	410.1	471.3
Other Revenue	50.9	97.4	76.0	72.6	58.4	60.3
Total Revenue	2294.9	2710.2	2805.4	3634.1	3239.5	4015.0
EXPENSES						

HR Compensation	587.2	649.1	732.8	1035.8	846.7	1117.2
Clerical & Admin. Employee Expenses	370.1	429.8	471.0	610.1	604.5	711.4
Partners & Officers - Employment Expenses	153.0	191.0	213.1	258.1	221.2	273.9
Other Employee Costs *	64.1	28.3	48.7	67.6	121.0	131.9
Floor Expenses	126.0	121.7	135.9	174.2	166.1	103.6
Brokerage Paid to Brokers	31.3	30.8	35.6	40.0	38.2	42.9
Commissions & Clearance	73.7	65.0	74.4	102.2	93.2	114.7
Clearance Paid to Non-Brokers	21.2	21.7	25.4	31.4	34.7	36.0
Commissions Paid to Others *	0.0	1.2	0.0	0.0	0.0	0.0
Communications	140.7	201.5	200.9	237.1	261.6	249.2
Occupancy & Equipment	80.4	126.6	135.4	168.4	196.5	219.4
Proportional Costs	55.2	74.3	75.6	94.0	97.8	104.7
Interest Expense	237.1	424.4	310.3	297.5	424.4	366.4
Losses-Errors and Bad Debts	18.7	19.7	22.0	28.3	23.4	27.6
Data Processing Costs	30.0	34.1	38.0	51.0	55.5	44.4
Non-Recurring Charges	7.6	13.4	0.4	2.0	11.7	4.4
Regulatory Fees and Expenses	13.1	14.8	18.7	27.4	28.9	33.3
Other Expenses	96.3	116.2	139.4	187.9	215.0	244.5
Total Expenses	1956.4	2415.8	2494.5	3176.4	3155.4	3636.5
Net Income	337.5	303.4	310.9	457.7	84.1	378.5
Net Income-After Tax	192.3	163.9	167.9	247.2	45.4	204.4

* From FOCUS Short Form, III

Table 12

\$ PRE-TAX PROFIT PER EMPLOYEE

<u>Firm Category</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
National Full Line	8,855	6,216	8,682	9,854	(963)	7,367
Large Investment Banks	41,144	48,831	60,903	57,345	45,988	65,497
Regionals	N/A	9,713	9,870	13,341	2,324	10,618
New York City Based	N/A	17,175	18,504	28,688	12,922	20,541
NYSE Discounters	N/A	23,077	23,970	29,852	529	16,027
Total Securities Industry	16,180	13,349	17,750	19,917	7,749	19,290

On the expense side of the income statement, the LIBs' lower labor roll and high leverage show their labor and interest expenses having an inverse relationship to the NFLs or the industry as a whole. While the industry's employment expense has averaged just under 40% of all revenues and the NFLs just under half of all revenues, the LIBs' employment costs have averaged less than a quarter of all revenues. On the interest expense side, while the industry's expenses ate up a quarter of all revenues on average through the Eighties and the NFLs, 17.5%, LIBs' interest expense has hovered between 41% and 52% through the Eighties, landing at 47% last year.

But as said, the leverage and targeting plan is working and translating into excellent bottom line performance. And, as was true with the industry as a group, the picture bodes well for 1986. Most revenues and profits were made during the fourth quarter of last year. From individual quarterly reports and FOCUS data already compiled, the first quarter of 1986 will show an even greater return rate than 1985's fine final quarterly showing.

REGIONAL FIRMS

At first blush, Regional firms' 350% rebound in pre-tax profits last year would seem cause enough for celebration. But isolated number crunching often can obscure the big picture better than a San Francisco fog can veil the Golden Gate. Compared to 1983, the Regionals' best year ever, 1985's profitability performance was down 17% on a pre-tax basis. And retracing their performance a few more years back, to 1980, last year's profits were only 12% better. As if that wasn't bad enough, in real dollars (inflation adjusted to the Consumer Price Index) last year's pre-tax profits by the Regionals was down 29% from 1980.

Table 13

STATEMENT OF INCOME
NEW YORK CITY BASED FIRMS
(In \$ millions)

	1980	1981	1982	1983	1984	1985
REVENUE						
Commissions	637.7	503.6	629.2	794.3	660.8	672.0
Listed Equities, On or Exchange	497.2	454.3	463.1	566.8	503.3	635.3
Listed Equities, OTC	5.5	5.0	3.5	12.0	16.2	27.2
Options	48.4	44.1	45.4	43.7	46.5	54.7
All Other	46.0	98.1	117.1	171.7	107.9	163.7
Gains/Losses from Trading Accounts	141.1	152.4	148.1	259.4	206.2	340.7
Net Making-OTC Equities	50.5	46.5	38.5	73.4	31.5	47.5
OTC Net Making-Listed Equities	0.0	0.0	0.0	0.3	7.0	3.4
Trading-Debt Securities	51.7	55.4	95.5	100.5	113.4	164.4
Net Making-Options	1.6	2.1	2.9	4.2	14.3	7.2
All Other Trading	38.0	48.5	51.3	73.0	41.9	111.7
Gains/Losses from Investment Accounts	56.8	66.2	106.6	73.0	62.7	74.1
Realized Gains/Losses	55.7	67.7	80.5	83.5	56.5	65.1
Unrealized Gains/Losses	1.0	-1.5	27.9	-10.5	6.0	7.4
Profits/Losses from Underwriting	45.0	81.4	72.9	86.4	33.4	62.4
From Equities	11.5	14.4	11.2	37.9	10.5	17.4
From Interest	192.6	274.4	163.9	174.5	230.0	204.4
Revenue from Sale of						
Investment Company Shares	2.4	3.0	7.6	11.4	4.6	24.1
Fees-Supervision, Advisory, Administrative	23.3	30.3	33.4	64.2	114.7	165.1
Revenue from Research Services	10.2	4.1	3.3	3.4	2.5	2.1
Commodities Revenue	5.0	6.6	10.4	12.3	17.4	10.4
Other Revenue-Securities-Related	220.5	241.2	196.4	221.7	240.6	275.7
Other Revenue	14.4	14.1	12.5	47.4	127.2	31.1
Total Revenue	1340.0	1465.6	1433.6	1753.6	1764.5	2071.0
EXPENSES						
HO Compensation	221.0	220.6	235.0	306.7	264.4	364.4
Clerical & Admin. Employee Expenses	199.2	239.3	259.0	298.9	321.6	395.4
Partners & Officers - Employment Expenses	47.7	87.6	90.3	96.5	84.4	83.0
Other Employee Costs *	0.0	0.0	0.0	0.0	0.0	12.5
Floor Expenses	131.0	121.3	117.0	140.7	139.5	186.7
Brokerage Paid to Brokers	39.5	38.0	42.2	45.3	40.1	51.1
Commissions & Clearance	79.5	70.1	61.8	81.0	93.0	109.9
Clearance Paid to Nonbrokers	12.4	13.2	13.6	14.4	16.4	15.0
Commissions Paid to Others *	0.0	0.0	0.0	0.0	0.0	4.1
Communications	42.1	72.6	76.5	74.1	86.4	104.1
Occupancy & Equipment	83.0	49.2	61.0	65.1	83.1	107.4
Proportional Costs	25.2	31.2	30.4	29.0	34.7	43.1
Interest Expense	295.7	347.9	236.3	257.5	346.6	267.9
Losses-Errors and Bad Debts	7.8	3.6	7.7	6.9	9.4	10.7
Data Processing Costs	15.4	12.9	21.7	27.2	26.5	29.0
Non-recurring Charges	1.4	1.2	1.4	0.4	3.5	30.6
Regulatory Fees and Expenses	9.4	9.6	16.5	17.5	13.1	22.4
Other Expenses	76.5	90.3	79.5	111.9	137.2	145.6
Total Expenses	1157.4	1238.7	1232.5	1432.5	1553.5	1817.3
Net Income	200.6	147.1	201.1	321.1	151.0	253.7
Net Income-After Tax	108.3	101.0	108.6	173.4	81.5	137.0

* From FOCUS Short Form, III

This group's bread and butter revenue source, commissions, fell in line with the industry as a whole in terms of relative contribution to total revenues. For the Regionals, the 34% commissions contributed to total revenues last year was 12% less than they contributed (46%) back in 1980. The comparable drop for the industry was 14% over these six years. However, the Regionals trailed the industry in how higher trading gains helped offset the lost commissions. Underwriting revenues last year accounted for 15% of all revenues, the most (sans 1983's 17%) it comprised during the Eighties. A hefty 35% of underwriting revenues were made during last year's fourth quarter. On one hand this could bode well for the Regionals this year since corporate underwritings during 1986's first quarter were way up to record levels of \$68 billion. On the other hand, however, municipal financings, one of the Regionals' strong suits, dramatically fell off to just \$11 billion, a mere 5% of full year 1985's record amount.

Other measures of profitability also point to the albatrosses on the Regionals' horizon. Disregarding 1984, last year's 9.4% pre-tax profit margin was the lowest of the Eighties. Their pre-tax return on equity (their level of leverage has held steady at assets nine times equity) of 29% was also the lowest of the Eighties (again, sans 1984) and only one other major group, NYSE Discounters, came in with a lower figure, 26%.

Regionals' employment costs last year ate up 52.4% of all revenues. That was up from 51.7% in 1984 even though the Regionals were the only major firm category to reduce overall employment in 1985! Reductions in hiring helped the revenue per employee figure to rise to \$112,629 in 1985 but the pre-tax profit per employee figure of \$10,618 last year was well below the \$13,341 showing back in 1983.

In sum, the Regionals as a group are losing ground within the industry. They account for 26% of all the NYSE firms doing a public business but last year garnered only 10% of this group's revenues, down from 14% back in 1980, and only 9% of pre-tax profits, down from 15% in 1980.

NEW YORK CITY BASED

The New York City based Regionals have experienced the same problems as their counterparts in other cities. As a group, they make up 13% of NYSE firms doing a public business but have seen their share of this group's total revenues fall to 5% last year from 8% back in 1980. Likewise, their share of pre-tax profits is down to 6% in 1985 from 9% back in 1980. Their pre-tax margins (excluding 1984) hit their lowest level of the Eighties last year. The \$254 million of pre-tax profits achieved last year was 21% less than 1983's \$321 million and adjusted for real dollars (using the Consumer Price Index) last year's pre-tax profits were 14% less than six years earlier.

Table 14

STATEMENT OF INCOME
COMMISSION INTRODUCING FIRMS
(In \$ millions)

	1980	1981	1982	1983	1984	1985
REVENUE						

Commissions	281.9	240.0	355.8	500.0	430.3	417.7
Listed Equities, On an Exchange	225.0	225.8	277.5	379.6	332.4	333.4
Listed Equities, OTC	0.0	0.0	0.2	0.0	0.0	0.1
Options	15.4	14.9	14.6	21.7	20.5	20.3
All Other	37.6	34.4	39.5	98.6	77.3	53.9
Gains/Losses from Trading Accounts	55.0	51.0	104.9	146.6	144.2	171.5
Net Making-OTC Equities	0.0	0.0	0.0	0.0	0.0	4.6
OTC Net Making-Listed Equities	0.0	0.0	0.0	0.0	0.0	0.0
Trading-Debt Securities	0.0	0.0	0.0	0.0	0.0	0.0
Net Making-Options	0.5	0.8	4.5	1.2	-1.0	0.6
All Other Trading	54.5	49.9	100.4	145.5	155.3	166.4
Gains/Losses from Investment Accounts	23.1	22.1	47.4	64.5	27.7	48.7
Realized Gains/Losses	0.0	0.0	0.0	0.0	0.0	0.0
Unrealized Gains/Losses	0.0	0.0	0.0	0.0	-0.4	0.0
Profits/Losses from Underwriting	29.8	42.1	33.5	110.4	48.2	68.1
From Equities	0.0	0.0	0.0	0.0	0.0	0.0
Margin Interest	0.0	0.0	0.0	0.0	0.0	-0.7
Revenue from Sale of						
Investment Company Shares	1.0	1.2	4.6	14.3	17.6	24.3
Fees-Supervision, Advisory, Administrative	23.2	30.9	37.4	55.5	53.1	60.5
Revenue from Research Services	0.0	0.0	0.0	0.0	0.0	0.0
Commissions Revenue	-1.3	4.1	5.7	2.7	2.4	7.7
Under Revenue-Securities-Related	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	77.0	79.3	104.7	153.4	172.4	105.4
Total Revenue	500.9	506.5	676.1	1045.4	910.5	902.2
EXPENSES						

NO Compensation	0.0	0.0	0.0	0.0	0.4	0.0
Clerical & Admin. Employee Expenses	0.0	0.0	0.0	0.0	0.0	0.0
Partners & Officers - Employment Expenses	50.0	63.7	72.4	91.4	76.4	33.4
Other Employee Costs *	160.1	175.4	229.3	340.2	333.5	271.3
Floor Expenses	33.9	30.2	39.8	57.4	55.5	62.4
Brokerage Paid to Brokers	0.0	0.0	0.0	0.0	0.0	0.0
Commissions & Clearance	0.0	0.0	0.0	0.0	0.0	0.0
Clearance Paid to Non-Brokers	0.0	0.0	0.0	0.0	0.0	0.0
Commissions Paid to Others *	33.4	30.2	39.6	57.4	55.5	62.4
Communications	0.0	0.0	0.0	0.0	0.2	0.0
Occupancy & Equipment	0.0	0.0	0.0	0.0	0.5	0.0
Promotional Costs	0.0	0.0	0.0	0.0	0.2	0.0
Interest Expense	32.4	37.4	19.2	31.8	53.1	22.4
Losses-Errors and Bad Debts	0.0	0.0	0.0	0.0	0.0	0.0
Data Processing Costs	0.0	0.0	0.0	0.0	0.0	0.0
Non-recurring Charges	0.0	0.0	0.0	0.0	0.0	0.0
Regulatory Fees and Expenses	4.3	4.3	5.0	4.6	9.2	10.7
Other Expenses	124.9	141.2	202.7	312.8	300.0	272.1
Total Expenses	415.4	451.1	568.5	690.4	629.6	723.3
Net Income	44.5	55.4	107.6	286.2	86.9	178.9
Net Income-After Tax	45.6	29.9	58.1	111.3	46.9	94.6

* From FOCUS Short Form IIA

This group didn't experience as big an erosion of commission dollars' relative importance to all revenues as the industry and other groups did. Over the Eighties, NYCs' commissions as a percent of revenues fluctuated between 40% and 47%, settling at 42% last year. Trading gains importance to all revenues for NYCs followed the industry's increase, going from 10% of all revenues in 1980 to 16% last year. Underwriting profits, however, were the lowest of the Eighties (forgetting 1984's off-year again), and this in a record underwriting period.

One of the only saving points was that the final quarter of 1985 accounted for 40% of the NYCs' pre-tax profits. Hopefully this is being carried over into this year and results will improve this go-round.

COMMISSION INTRODUCING FIRMS

Though the Commission Introducing firms make up 31% of the NYSE firms doing a public business, last year they garnered only 4% of this group's pre-tax income. Even though this group's pre-tax profits doubled last year and even though its expenses have declined for two straight years, its revenues have fallen from \$1.1 billion in 1983 to \$902 million last year so that its pre-tax profits have fallen 13% over the two years. And though in aggregate, particularly revenues, the CIs have been losing ground, their new found control of expenses has been improving the margins they are showing on what revenues they do bring in. For instance, its pre-tax profit margin of 19.8% was its best showing in the Eighties and the highest showing of any firm category (excluding the "other firms" catch-all group). Their 1985 44.5% pre-tax return on equity was the best of any firm category and one-and-one-half times the industry average although in other years, like 1983's 53.2% ROE, it has been higher.

Table 15

<u>Firm Category</u>	<u>PRE-TAX RETURN ON EQUITY</u>					
	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
National Full Line	45.0	24.6	29.8	28.1	(2.6)	17.9
Large Investment Banks	55.7	56.7	54.8	43.8	31.1	38.5
Regionals	N/A	37.2	36.0	40.5	6.8	29.0
New York City Based	N/A	42.1	43.3	50.7	19.9	31.2
Commission Introducing	N/A	28.3	46.9	53.2	19.4	44.5
NYSE Discounters	N/A	52.2	53.9	46.7	0.8	25.6
Total Securities Industry	49.2	35.9	40.5	36.6	13.3	29.4
U.S. Manufacturing Cos.	21.9	21.4	14.1	16.3	19.2	15.7

Table 16

STATEMENT OF INCOME
NYSE DISCOUNTERS
(In \$ millions)

REVENUE	1940	1941	1942	1943	1944	1945
Commissions	44.1	72.7	146.4	254.1	232.3	294.6
Listed Equities, In An Exchange	40.6	51.4	113.4	145.6	155.5	164.2
Listed Equities, OTC	0.0	3.6	3.3	0.2	0.4	0.3
Options	3.6	8.4	19.4	30.0	29.4	35.2
All Other	3.9	5.4	9.5	42.2	46.6	74.4
Gains/Losses from Trading Accounts	0.0	0.3	1.4	5.0	4.6	5.7
Net Making-OTC Equities	0.0	0.0	0.1	0.4	0.2	0.7
OTC Net Making-Listed Equities	0.0	0.0	0.0	0.0	0.0	0.0
Trading-Debt Securities	0.0	0.0	0.7	1.5	1.2	1.4
Net Making-Options	0.0	0.0	0.0	0.0	0.0	0.0
All Other Trading	0.0	0.3	1.1	2.7	3.0	4.2
Gains/Losses from Investment Accounts	0.0	0.0	5.2	1.7	0.5	2.3
Realized Gains/Losses	0.0	0.0	1.0	0.1	0.0	0.0
Unrealized Gains/Losses	0.0	0.1	3.5	0.2	0.1	0.2
Profits/Losses from Underwriting	0.0	0.2	1.5	1.7	1.5	0.9
From Equities	0.0	0.0	0.1	0.3	0.0	0.0
Margin Interest	1.8	17.7	36.2	43.1	72.6	47.4
Revenue from Sale of						
Investment Company Shares	0.0	0.0	0.0	0.5	1.9	3.2
Fees-Supervision, Advisory, Administrative	0.1	0.0	0.0	0.0	0.0	0.0
Revenue from Research Services	0.5	0.0	0.0	0.6	0.7	0.0
Commodity Revenue	0.1	0.1	0.3	0.3	0.5	0.4
Other Revenue-Securities-Related	1.7	4.0	2.3	14.2	22.2	53.3
Other Revenue	3.6	13.4	12.5	16.7	16.7	29.0
Total Revenue	61.3	115.5	213.9	345.4	356.4	441.4
EXPENSES						
HR Compensation	2.3	6.6	14.9	14.7	21.9	23.2
Clerical & Admin. Employee Expenses	1.4	12.0	23.0	35.3	38.8	62.2
Partners & Officers - Employment Expenses	3.1	4.4	6.3	9.2	7.3	14.0
Other Employee Costs *	7.6	7.3	9.0	25.5	26.5	24.7
Floor Expenses	12.7	19.3	27.2	44.5	50.0	54.5
Brokerage Paid to Brokers	1.1	1.5	1.7	7.3	5.5	1.5
Commissions & Clearance	1.4	5.5	11.0	6.2	7.0	12.1
Clearance Paid to Non-Brokers	0.4	0.4	2.1	4.4	5.0	4.0
Commissions Paid To Others *	9.6	11.4	10.4	30.6	32.5	31.2
Communications	1.2	9.3	16.3	23.7	30.1	34.6
Occupancy & Equipment	0.4	4.6	10.3	13.1	25.7	33.3
Promotional Costs	0.0	4.3	7.4	11.4	13.5	14.4
Interest Expense	1.5	0.2	25.2	34.4	55.4	75.0
Losses-Errors and Bad Debts	0.1	0.7	2.2	3.1	2.1	2.4
Data Processing Costs	0.6	2.5	7.7	9.8	10.9	17.4
Nonrecurring Charges	0.0	0.0	0.1	0.1	0.0	0.0
Regulatory Fees and Expenses	0.5	0.3	1.1	2.4	2.1	3.0
Other Expenses	18.0	20.0	33.1	62.2	67.6	74.0
Total Expenses	50.6	101.4	144.4	297.6	355.3	441.4
Net Income	10.7	14.1	29.1	44.3	1.1	47.0
Net Income-After Tax	5.4	7.5	15.7	25.1	0.6	23.2

* From FDICUS Short Form, IIA

This drop-off is partly due to this group's "unleveraging" over the past few years. Their assets to equity ratio has dropped from five times in 1983 to just two times last year. Even though their equity has fallen from \$485 million in 1983 to \$425 million last year (it dipped further in 1984 to \$391 million), the liabilities side of the balance sheet has experienced much more dramatic drop-offs.

The \$524 million of liabilities at 1985's close was the lowest of the Eighties and less than one-third of the \$1.8 billion of liabilities at 1983's close. Some liabilities fell drastically such as payables to dealers, brokers and clearance houses, down to \$58 million last year from \$725 million at 1983's close.

NYSE DISCOUNTERS

Based on the 27 NYSE member Discounters doing a public business, which account for the largest Discounter firms and a majority of Discounter revenues, 1985 was their second best year ever. Pre-tax profits rose from \$1.1 million in off-year 1984 to \$43 million last year, but that was still below 1983's \$48.3 million performance. Revenues, however, were at record levels, \$485 million last year, a 40% increase over two years. Expenses, however, increased 48% over the same two years to \$442 million in 1985. The biggest expense item was interest expense and over the two years 1983 to 1985, this increased 116% to \$75 million. That's over 15% of the Discounters' 1985 revenues...two years earlier it was only 10%.

But this was mainly due to the balance sheet exploding for this group during the same period with assets more than doubling to \$1.8 billion, mostly from increased liabilities which stood at \$1.6 billion at 1985 year-end.

Commission income for this group, as for the industry, has become a smaller contributor to total revenues. In 1980 its contribution stood at 79%. Last year it stood at only 62%. This is still, by fact as well as definition, the Discounters main income source but as little as two years ago (1983) commissions were accounting for 75% of all revenues.

That isn't to say that aggregate commission dollars were down, from 1983 to 1985 they increased from \$258 million to almost \$300 million. But that's just 16% over two years. Meanwhile, the Discounter's bread and butter revenue source, retail sales, have been exploding. According to SIA's Investor Activity Report, the most sophisticated and new measure of retail activity which takes member trading statistics (which are mandated to be reported to the various exchanges) and institutional trades by the largest institutions out of the total share activity, and is not just an arbitrary retail proxy, retail activity has been blossoming.

Though the data is available only from May 1985 forward, the Report shows from May through year-end last year, public activity on the Big Board alone (excludes member trading) mushroomed 42%. Meanwhile, while public activity skyrocketed, the retail share of this volume increased from 38% to 40% by December. The latest figures show public activity increasing even further and as of March the retail portion of this increase climbed even higher to 44%. Similar patterns held true for the AMEX and OTC markets.

Therefore the commission revenue of Discounters, though up, is not up as much as one would think. The one favorable sign for the Discounters is that while commission revenues hovered around \$70 million per quarter in 1985's first three quarters, Q4's showing jumped to \$85 million.

Data for NASD Discounters was unavailable for this issue of TRENDS but will be included in the next issue dealing with firm category profitability.

OTHER FIRMS

This residual category of securities firms covers nine Traders & Market Makers, a dozen Clearing firms and 46 non-classified houses.

As a group, they make up 24% of the NYSE firms doing a public business and as a group have been making inroads similar to the Large Investment Banks, albeit on a much smaller scale. In 1980 these firms accounted for just 5% of the total group's revenues and 9% of their pre-tax income. By last year this share had increased to 7% of revenues and a hefty 15% of pre-tax profits. And their profit margin of 24.8% last year matched their best showing of the Eighties, 24.8% in 1982. That figure was also the highest of any firm category during any of the past six years!

Of this group, the nine Traders & Market Makers had the most stellar improvement last year. From 1980 to 1984, the TMM's averaged a pre-tax income of \$55 million (the lowest being \$20 million in 1981 and the highest being \$82 million in 1982). Last year, however, profits inflated faster than a balloon mortgage. The \$228 million turned in was more than four times their 1980-84 average. The big gains came from debt trading and investment accounts.

The Clearing firms made a comeback from disastrous 1984, but last year's \$13.5 million pre-tax profits was about the same as the \$13.2 million earned in 1980, and that's before adjustment for inflation.

The unclassified firms had their best year in 1985. Pre-tax 1985 profits hit \$339 million. That was 53% better than their previous high showing of \$222 million in 1983.

CONCLUSION

The securities industry has just come off its new record year and while all firm categories benefited from the up markets, some, particularly Large Investment Banks, benefited much more than others. Margins and other measures of profitability made sharp rebounds (they almost had to) from 1984 but most firm categories have seen better years when relative measurements and price deflators are studied. The fourth quarter, while the bull was in full force, was the predominant money maker for all firm categories. Therefore, with the same bull market forces in play thus far in 1986, securities firms should be addressing the weak and strong points for their category to take advantage of what can possibly be another record breaking year. And as noted in this month's TRENDS Flash, preliminary data shows that the first quarter already matched half of all last year's pre-tax securities industry record net.

George R. Monahan
Assistant Director of Research

VOLUME

	MARCH 1986	JAN - MAR 1986	MARCH 1985	JAN - MAR 1986	% CHAN. J-M 1986-1985
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	160.8	148.1	102.6	113.2	30.8%
AMEX (MILS.)*	15.9	13.7	8.7	9.4	45.9%
NASDAQ (MILS.)*	129.8	120.4	76.8	84.0	45.2%
REGIONAL EXCHANGE (MILS.)*	27.7	25.2	20.2	19.8	26.9%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	\$123,696	\$37,321	\$76,916	\$242,187	59.3%
AMEX (MILS.)	1,687	7,399	2,465	7,025	5.3%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	10,348	26,867	6,618	20,375	31.9%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	21,787	59,516	16,404	49,510	20.2%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.0%	49.4%	50.9%	51.0%	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	16,395	47,472	12,060	37,236	27.5%
AMEX OPTIONS	4,378	14,856	2,914	9,131	62.7%
COMMODITY	15,140	47,183	13,602	39,667	18.6%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES)

MARCH 1986	MARCH 1985	BASIS POINT CHG 1986-1985
7.20%	9.77%	(257)
9.00	12.56	(356)
10.50	13.69	(319)
0.86	0.92	(6)
7.08	9.77	(269)

BOND BUYER INDEX (20 BOND)
 CORPORATE BOND YIELDS (MOODY'S)
 Aaa CORPORATE
 Baa CORPORATE
 RATIO Aaa CORPS. TO Baa CORPS.
 MUNICIPAL BOND YIELDS (MOODY'S)

PRICES (END OF MONTH)

APRIL 1986	APRIL 1986	% CHAN. Y-T-D 1986-1985
1783.98	1258.06	41.80%
235.52	179.83	30.97%
135.75	104.12	30.38%
268.97	227.44	18.26%
238.6	191.58	24.54%
383.24	280.56	36.60%

DOW JONES INDUSTRIALS
 STANDARD & POOR'S 500
 NYSE COMPOSITE
 AMEX MARKET VALUE INDEX
 VALUE LINE COMPOSITE
 NASDAQ COMPOSITE

UNDERWRITING

	APRIL 1986	APRIL 1985	% Change 1986-1985
CORPORATE FINANCING (Gross New Issues - \$ Mills)			
TOTAL	\$33,221.5	\$11,147.3	198.0%
Common Stock # of Common Stock Issues	\$5,041.8 112	\$2,094.9 63	140.7% 77.8%
Preferred Stock # of Preferred Stock Issues	\$871.0 14	\$643.3 12	35.4% 16.7%
Corporate Debt # of Corporate Debt Issues	\$37,308.7 194	\$8,409.1 89	343.7% 118.0%
MUNICIPAL FINANCING (Gross New Issues - \$ Mills)			
Notes Bonds	\$3,776.8 \$11,144.7	\$4,684.6 \$10,732.7	-19.4% 3.8%

Source: IDD Information Services and Bond Buyer

MARGIN DEBT OUTSTANDING (\$MILS)

NET CHANGE IN MARGIN DEBT (\$MILS)

% OF ACCOUNTS WITH EQUITY UNDER 40%

MARGIN DEBT

MARCH 1986	MARCH 1986	% CHANGE 1986-1985
30.760	23.900	28.7%
6.860	1.071	540.5%
10%	11%	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item

Report on Production of RRS
in 1985 & Earnings

Description

SIA's thirteenth annual survey on RR production and earnings levels and trends, including data on payout percentages and ticket size. Information on the newly registered retail RR is an added feature providing information on production earnings and and training costs. Report is based on input from

Source

SIA
Surveys Department
\$400 1st copy, \$50
additional copies
for SIA member firms;
\$1,200 1st copy, \$50
additional copies
for all others

"Summary of Senate Tax
Reform Provisions"

A convenient and official summary listing of the principal tax reform proposals in the Senate Finance Committee bill. (Legislative documentation and Committee report not yet available.)

Bureau of National Affairs
5/13/86

Investment Banking and Diligence
What Price Deregulation?

Harvard Professors Auerbach and Hayes explore Rule 415 and its implications for due diligence. Starting with a perspective on the evolution of the securities industry since 1920, the authors detail competitive conditions at the time of passage of the Securities Act of 1933 and procedures which followed from it. These procedures are reviewed in the context of today's competitive pressures. What has occurred since the existence of Rule 415 is analyzed, including shifts in underwriting status of investment banks. Conclusion: Regulatory changes along the lines of Rule 415 were probably inevitable, but the SEC's deregulation procedure needs to be reconsidered.

1986 Harvard Business
School Press
Boston, Massachusetts

"Do Institutions Still Get
the First Call?"

Author Charles Ellis gives a behind the scenes assessment of how the rules are changing in the institutional equity business, along with attitudes toward investment research. Q & A section, supported by data tables, on commission allocation and broker research.

Investment Decisions
May 1986

**"Charles Schwab vs. Les Quick:
Discount Brokering's Main Event"**

Business Week
5/12/86

Article describes the unique personalities and very different operating strategies of these two discounters. Radically different styles have lead to radically different growth paths for the respective companies: Schwab's revenue growth has been dramatic, while Quick's profitability has been remarkable.

NASD 1985 Fact Book

NASD
1735 K Street, N.W.
Washington, DC 20006

Comprehensive statistical fact book, including much historical data. 1985 was a record-setting year for the NASDAQ market, with share volume hitting 20.7 billion and single-day record volume reaching 141.5 million shares. The dollar volume of shares traded amounted to \$233.5 billion, up 50% from 1985.

**Annual Report of the Federal
Reserve Bank of New York**

**Federal Reserve Bank of
New York**
Public Information
33 Liberty Street
New York, NY 10045

1985 Report departs from tradition and presents a broad essay on the major features of financial change at work now. The forces focused on are innovation, competition, deregulation, securitization, and the associated growth of trading of financial instruments. Challenge ahead: understanding of new markets and techniques and their affect on the whole financial system.

"The Fortune 500"

Fortune
4/28/86

Thirty-second annual listing of the 500 largest U.S. industrial companies. GM toppled Exxon as king of the hill in 1985. Special report runs 58-pages and includes the 500 by industry and ranked by 14 measures, the biggest turnaround, and the biggest money loser.